Testimony of G. Edward DeSeve
Professor University of Maryland School of Public Policy
Sub-Committee on Government Efficiency and Financial Management
Committee on Government Reform
September 15, 2004

Thank you for inviting me here today to testify regarding the evolution and development of the Chief Financial Officers Act as well as the organizational standing and authority of Chief Financial Officers.

Evolution and Development of the CFO Function

My perspective comes from having served in state and local government as well as the federal government and the private sector. In each of these areas, the role of Chief Financial Officer is central to planning, assuring results and managing resources and assets. The Chief Financial Officers Act of 1990 codified these responsibilities within the federal government as follows:

"Provide for improvement, in each agency of the Federal Government, of systems of accounting, financial management, and internal controls to assure the issuance of reliable financial information and to deter fraud, waste, and abuse of Government resources." (Section 102 (b)2)

This was both a broad and ambiguous charge. The lack of inclusion in Section 902 "Authority and functions of agency Chief Financial Officers" of specific authority to compile and oversee execution of agency budgets led to significant discord between agencies and the Office of Management and Budget. Many in Congress, especially in Appropriations Committees, argued that the CFO's duties need not include budgeting. OMB argued otherwise and agencies typically chose the course of action that was most conducive to their own designs.

Also ambiguous was the phrase, "report directly to the head of the agency regarding financial management matters". Did this mean that the individual did not report to the head of the agency on other matters? OMB attempted to solve this ambiguity by suggesting that reporting to the "Office of the Secretary" was sufficient to meet the standards of the Act. Thus, most CFO's in the CFO Act Agencies were of Assistant Secretary rank (PAS IV). This often led to conflict with existing Assistant Secretaries for Management and Budget (ASMB) who saw themselves as the Chief Management Officers of Departments.

These issues are largely behind us today. Accommodations have been made and accepted. For example, The Department of State designated the Under Secretary for Management as the Chief Financial Officer. One size did not fit all and the execution of the functions proved more important than the purity of organizational design. Over time, the overwhelming majority of CFOs gained the budget function and the office of ASMB became less common especially with the passage of the Information Technology and Management Reform Act of 1995 and the recommendation by the National Performance Review in 1993 that Deputy Secretaries take on the responsibilities of Chief Operating Officers. The Deputy Secretaries role was further reinforced by the creation of the President's Management Council which has continued during the current administration.

Focus on Functions

The starting point for implementation of the CFO Act was a focus on producing audited financial statements and achieving a clean audit opinion. This came from the provisions of Section 303 of the Act which focused on agency financial statements. This focus was heightened by the Government Management Reform Act of 1996 which added the requirement for a government-wide financial statement audited by the General Accounting Office.

Manpower and system resources were dedicated to the auditing function to the detriment of other functions such as the development of budget and performance tracking systems. However, the rise of the "integrated financial system" offered the promise that comprehensive financial information could be produced for multiple purposes. Many agencies moved from old transaction processing systems to the new integrated systems as a means of achieving automated financial statement data integration. This succeeded the "heroic" manual processes that early on had been used to obtain clean audit opinions.

If the first two functions undertaken were producing financial statements and implementing new financial systems, many agencies found that tracking assets was an additional burden that they were ill prepared to address. This was true of both physical assets and financial assets. Here operational managers became more involved. The assertion by the General Accounting Office (GAO) that the Defense Department had "lost" vessels and aircraft engines stirred action to tie physical inventory systems to financial systems. More importantly, the Debt Collection Improvement Act of 1996 added emphasis on the stewardship responsibility for financial assets. Together with the work of the Federal Credit Policy working group, DCIA began focusing CFO's on the function of managing large portfolios of financial assets. This was particularly true in credit granting agencies such as Housing and Urban Development, Agriculture, Veterans Affairs and Education.

The process of developing financial statements identified the poor internal control of financial assets and DCIA provided both sanctions and tools to deal with the true cost to the federal government of poor stewardship. An example was the multi-family loan portfolio at the Department of Housing and Urban Development (HUD). The first step in dealing with the problems of this portfolio was to properly characterize the value and conditions of the assets. In other words, HUD did not know the value or the condition of the buildings that were guaranteed or financed under its various programs. The CFO's office worked closely with the program office to develop a proper monitoring program for the portfolio. This lead to the ability to sell the assets to the public as provided for in

DCIA. This proved an expeditious way to get them off the federal books as a liability and allowed the properties to become community assets.

CFOs also were actively involved in assuring proper operation of new programs. The William D. Ford Federal Direct Loan Program of the Department of Education was initiated under the financial aegis of the Chief Financial Officer of the Department of Education It was the largest federal loan program enacted subsequent to the passage of the Credit Reform Act of 1990 and its initial implementation led to significant concern as reflected in the General Accounting Office High Risk Series Report of 1997.

While this concern has not entirely evaporated, establishment of the Federal Student Aid Performance Based Organization (PBO) and setting up a Chief Financial Officer within that PBO has provided focused leadership which has led to the decline in default rates and has helped the program to operate on a negative subsidy basis. A validation of improvement in financial management by the Federal Student Aid PBO is found in the March 2004 report of GAO entitled, "Department of Education's Federal Direct Loan Program: Status of Recommendations to Improve Cost Estimates and Presentation of Updated Cash Flow Information." This report reflects the progress made since an earlier 2001 GAO report regarding the program's credit subsidy reporting status .

In summary, CFOs have been shifting their focus from audit to management of assets and other stewardship activities. Further shifts are already underway in regard to implementing initiatives to track resources and results. The aggregate of these initiatives begins to mirror the functions found in private sector CFOs where the bottom line is both the income statement and the balance sheet.

Structure for the Future

The implementation of Chief Information Officers, Chief Human Capital Officers, Chief Procurement Officers as well as CFOs within agencies has led some to call for the integration of these functions, as in the past, under a Chief Management Officer. Indeed, GAO itself has such a "Chief Mission Support Officer". While this may be appropriate for agencies which have few tangible assets or do not handle large volumes of financial transactions, many agencies will want a CFO who reports directly to the Office of the Secretary and who plays a central role in working with the program managers.

In my opinion, the Deputy Secretary should be the Departmental Chief Operating Officer and the appropriate program as well as management officials should report to her or him. While there are many variants on organizational design, the COO concept has the great advantage of creating a single nexus of responsibility that can resolve program, policy and resource issues. The CFO should report directly to the COO who is acting for the Secretary or other most senior officer. The same is true for the other offices listed above. If a CFO with statutory responsibility is required to report through a management officer, their effectiveness and authority is likely to be diluted.

In some departments, such as Treasury, a second tier of CFO's in operating units has proved an effective way of managing the Department. While each of these CFOs reports to the program head, there is a dotted line relationship to the agency CFO. Often the agency CFO shares in the performance rating process of program level CFOs. In addition, department level CFO Councils have grown up to resolve common problems and to work on creative solutions to both financial and program issues. This depth of organization leads to a stronger central office and stronger programs. The depth of talent in the finance function is similarly enhanced.

That said most formal structures give way quickly to informal structures. I believe that the emergence of the concept of network management will ultimately render hierarchical organization charts obsolete. CFOs themselves are a primary example of the benefits of network management. The CFO Act established the Chief Financial Officers Council (CFOC) chaired by the OMB Deputy Director for Management. Initially, the Council was a transmission device where OMB could broadcast instructions to the CFO community. In the summer of 1993 this changed. Then OMB Director Alice Rivlin, at the urging of the CFO community, empowered the Council and gave its Vice Chair significant responsibilities to create a charter, convene the Council and take action on various matters concerning the community. At the same time, the Deputy CFOs were included as full member of the Council. This had the effect of directly involving the senior career staff who provide continuity across administrations into the decision making process.

Currently, the CFOC is undertaking initiatives in Erroneous Payments, Financial Statement Acceleration and Performance Measurement. OMB and Treasury are working closely with the Council to assure that the authority of the central agencies is used in a way that leverages the activities of each of the member CFO agencies to produce results. To quote the Council's Vision Statement they seek to succeed in "Shaping an environment in which government officials use high quality financial and performance information to make and implement effective policy, management, stewardship, and program decisions."

If, as George C. Marshall said, "The price of peace is eternal vigilance", the price of continued success in financial management is strong oversight and support for CFOs in agencies. This will allow them to work within their agencies and with central agencies as agents for positive change. As Comptroller General David Walker said in his testimony on March 3, 2004 this Committee has, "been a catalyst to facilitate government management reform." Your continued vigilance will go a long way toward continued progress in financial management.